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City Manager's Office

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Debra Figone

SUBJECT: BACKGROUND ON
COMPENSATION REDUCTIONS

DATE: September 7, 2012

INFORMATION

PURPOSE

Questions continue to be raised related to the 10% total compensation reduction taken by every City employee and official. This memorandum provides background information on the context regarding the decisions that were made at the time. In addition, as we begin the budget planning for Fiscal Year 2013-2014, it is important to provide this information as background for future City Council decision making regarding changes to total compensation.

FISCAL YEAR 2010-2011

When confronted with a \$118 million General Fund shortfall for Fiscal Year 2010-2011, which was being faced after nine years of shortfalls totaling \$447 million by that point in time, the City Council directed the City Manager to achieve a 10% reduction in total compensation (5% ongoing and 5% one-time). During that year's labor negotiations, as described below, the concessions achieved reduced the amount of service reductions and layoffs that would otherwise have been necessary to solve a \$118.5 million budget deficit for Fiscal Year 2010-2011.

The 10% total compensation reduction was not achieved for all City employees for Fiscal Year 2010-2011; however, for the approximately 1,800 employees and officials who received a 10% reduction in total compensation in Fiscal Year 2010-2011, half of that amount was one-time. For employees represented by the San Jose Police Officers' Association (SJPOA), the agreement reached and approved by the City Council in August 2010 achieved a 3.82% total compensation reduction that avoided the layoff of 70 Police Officers. Although the agreement was significant in that it avoided layoffs of Police Officers, the City considered it a "stop-gap" measure to give time to negotiate long term solutions with the SJPOA. During Fiscal Year 2010-2011, no concessions were achieved with the International Association of Fire Fighters, Local 230 (San Jose Fire Fighters). Unfortunately, despite these concessions in Fiscal Year 2010-2011, 185 full-time and 21 part-time employees were laid off, including 49 Firefighters.

FISCAL YEAR 2011-2012

In 2011-2012, the City addressed an additional General Fund shortfall of \$115 million. When faced with another large projected General Fund shortfall for Fiscal Year 2011-2012, the City Council directed the City Manager to achieve an ongoing 10% total compensation reduction

from all employees. When this direction was given on November 18, 2010, the City Council also approved Guiding Principles for the labor negotiations. One of those principles was to consider the inter-relationship of variations by bargaining unit because of the compaction issues that could be caused with variations in concessions, especially related to pay reductions. We reached agreements with seven of our eleven bargaining units, including the SJPOA and San Jose Fire Fighters, that achieved a 10% reduction in total compensation. Unfortunately, the City Council faced the difficult decision to impose the concessions on the remaining four bargaining units. The following table shows the savings achieved by the 10% total compensation reduction.

Savings from 10% Total Compensation Reductions
2011-2012 Base Budget

	General Fund*	All Funds*
San Jose Fire Fighters	\$13.9 million	\$13.9 million
SJPOA	\$23.3 million	\$23.3 million
Non-Sworn Employees	\$21.3 million	\$37.3 million
Total	\$58.5 million	\$74.5 million

* The total compensation reductions were partially offset by annual required retirement contributions of \$23.6 million in all funds and \$18.9 million in the General Fund, resulting in total net savings of \$50.9 million in all funds and \$39.6 million in the General Fund.

These significant concessions made by our employees are appreciated and their sacrifice is recognized. Without them, services to the public would have been greatly reduced further than had already occurred at the time.

"ME-TOO" CLAUSES

It is important to note that with three of the bargaining units the City reached agreements with (AEA, AMSP, and CAMP), the City and those bargaining units have "me too" clauses, which state:

In the event that the City reaches a settlement with any other employee unit covering the time period of this Agreement that has an ongoing total compensation reduction of less than ten percent (10%), in any form or manner, this agreement will reopen on the subject of total compensation and the parties will meet and confer to determine how the difference between a 10% ongoing total compensation reduction and the lesser amount agreed to with any other employee unit will be provided.

This provision will also apply in the event the City reaches a settlement which does not include the rollback of any general wage increase (not including any step and/or merit increases), as authorized by the City Council on November 25, 2010, received by any employee unit in Fiscal Year 2010-2011.

This provision will not apply to any changes made to any employee unit which occurs as the result of an interest arbitration award that is the result of contested issues resolved only via a full evidentiary hearing and substantive briefing.

This "me too" clause extends through June 30, 2013.

FISCAL REFORM PLAN

In further recognition of the City's fiscal challenges, the City Council unanimously directed the City Manager in March 2011 to develop a Fiscal Reform Plan to achieve \$216 million per year of cost reductions and/or new revenues for the General Fund that will allow us to restore services such as police, fire, libraries, and community centers to the levels of January 1, 2011, and to open the libraries, community centers, and fire stations built or under construction, and the police substation within five years. In May 2011, the City Council approved the Fiscal Reform Plan aimed at saving \$216 million in the General Fund over the coming five years and maintaining retirement costs at the Fiscal Year 2010-2011 levels.

CONTROLLING RETIREMENT BENEFIT COSTS

An important component of the Fiscal Reform Plan is to reduce the percentage of total compensation taken up by the cost of our retirement benefits:

[I]t is important to recognize that controlling our retirement costs may provide us the flexibility in the long term to make changes to pay. High retirement costs limit our ability to make changes in other areas of total compensation. It has been said that some employees would prefer more take-home pay. But with our retirement costs as high as they are, this limits the funds available to make changes to pay as the City's retirement costs are taking up more and more of an employee's total compensation.

Source: Fiscal Reform Plan, page 10.

In order to accomplish this, finding a way to lower retirement costs has been an important component of the Fiscal Reform Plan.

The City Council directed the City Manager to develop a proposed ballot measure regarding pension modification. This measure included setting parameters for a new tier of retirement benefits for new employees, developing a voluntary opt-in program with a lower level of benefits for current employees, requiring additional employee contributions if an employee chooses to remain in the current and more expensive plan, and requiring the vote of the people to enhance retirement benefits in the future. The ballot measure was developed during the meet and confer process over nine months and became Measure B on the June 5, 2012, ballot, which was passed overwhelmingly by San José voters. However, many of the provisions of Measure B are on hold due to pending legal actions. Thus, no savings have yet been achieved as a result of Measure B.

In addition, in 2010, Measure W was passed by City of San Jose voters, which allowed for the creation of a second tier of pension benefits. Measure B defined the maximum pension benefits allowed for new employees and a new tier for employees in the Federated City Employees' Retirement System will be effective for employees hired on or after September 30, 2012. Unfortunately, we have not yet reached an agreement with the SJPOA and San Jose Fire Fighters on a second tier and are proceeding to binding interest arbitration even though the City is willing to provide the maximum benefit allowable under Measure B.

FUTURE COMPENSATION INCREASES

Approximately 96% of the City employees are represented by one of the City's eleven bargaining units. For items subject to bargaining, there is an obligation to provide advance notice and an opportunity to negotiate, even when providing wage increases. Historically, the City has negotiated general wage increases that apply to all employees in a bargaining unit regardless of performance. As part of the Fiscal Reform Plan, it was recommended that when the City allocates funding to provide for pay increases, that those increases be given based on performance. Direction regarding performance based increases was provided by the City Council as part of the Mayor's June Budget Message:

Performance Based Increases: Even with savings achieved as the Fiscal Reform Plan is implemented, it is unlikely that the City will be able to grant annual across the board wage increases anytime soon. However, it is important to be able to reward excellent performance and provide pay raises based on merit. The City Manager is directed to continue moving towards a merit based system which would (1) require a current positive performance appraisal before implementing any pay increases (including step and general wage increases), (2) eliminate the automatic step increase process or establish minimum performance thresholds for receiving step increases and/or (3) implement a process for rewarding excellent performance with additional compensation. It is recognized that the current management pay plan already provides for performance based pay and therefore, can be used to reward excellent performance as resources allow. This plan has been in effect for many years and may need to be modified to reflect best practices moving forward. A fully merit based pay system for represented employees should be proactively explored through the meet and confer process with our bargaining units.

Source: June Budget Message for Fiscal Year 2012-2013, page 13.

It is also equally important that we reward high performing employees who are committed to San Jose and choose to stay to help the City through these difficult times. As the City Council is aware, the City organization has been and continues to work through the impacts of significant disruption to its basic administrative infrastructure due to cuts, turnover, bumping, and loss of institutional knowledge. An emphasis on back to basics is a current focus, including ensuring that employees receive annual performance appraisals. As we work with our bargaining units to develop performance based pay systems, we will draw upon City experience as approximately 850 of our employees are already in a pay for performance system. We will also work together to draw upon best practices.

COST OF TOTAL COMPENSATION INCREASES

In order to provide the City Council with the cost of total compensation increases for budget planning purposes, the following table shows the cost of giving a 1% and a 10% total compensation increase to all City employees, broken down by employees represented by the San Jose Fire Fighters, employees represented by the SJPOA, and non-sworn employees. It should be noted that this table does not take into account any potential changes in retirement contributions due to investment losses and actuarial assumption changes as well as any retirement contributions that would correspond with wage increases.

Estimated Cost of 1% and 10% Total Compensation Increases
Based on the 2012-2013 Adopted Budget

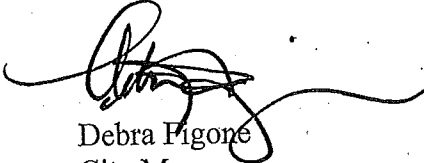
	1% Total Compensation Increase		10% Total Compensation Increase	
	General Fund	All Funds	General Fund	All Funds
San Jose Fire Fighters	\$1.2 million	\$1.2 million	\$12 million	\$12 million
SJPOA	\$2.1 million	\$2.1 million	\$21 million	\$21 million
Non-Sworn Employees	\$2.3 million	\$4.3 million	\$23 million	\$43 million
Total	\$5.6 million	\$7.6 million	\$56 million	\$76 million

To provide context, a 10% increase in total compensation would result in an approximate increased cost of \$56 million in the General Fund (\$76 million all funds), which would be equivalent to funding approximately 400 positions in the General Fund (approximately 550 positions all funds).

It should be noted that based on the 2013-2017 General Fund Forecast that was issued in February 2012, a budget shortfall of \$22.5 million is currently projected for 2013-2014. No general wage increases are included in that forecast with the exception of salary steps for eligible non-management employees and management performance pay. As part of the approval of the 2012-2013 Adopted Budget, the City Council set aside an earmarked reserve (\$9 million ongoing, \$13.5 million one-time) to cover this projected shortfall. However, as part of the budget planning process for the 2013-2014 Proposed Budget, this projected 2013-2014 General Fund shortfall will need to be refined based on updated information regarding revenue, retirement and healthcare contributions, obligations of the Successor Agency to the Redevelopment Agency, and other expenditures. With the context of the City's updated budget situation and forecast outlook, it is anticipated that total compensation increases for employees will be a City Council resource allocation decision as part of future budget processes that will consider both the City's service delivery system and workforce stabilization needs.

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As part of next steps, we will be bringing forward our annual summary of Labor Negotiations prior to the end of the calendar year and will be discussing with the City Council direction related to those negotiations.



Debra Figone
City Manager